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A SYSTEM FOR NAVY EXCHANGE MANAGEMENT CONTROL

By

Charles C. Madeira
Lieutenant Commander, Supply Corps, United States Navy

Managing the disparate departments of a Navy Exchange, accumulating and synthesizing data to select significant variables for detection of trouble areas, and initiating prompt corrective action for optimum monthly performance all complicate the control problem of a Navy Exchange Officer. In an effort to encourage balanced management control by all Exchange Officers in the Navy Resale System, this paper has attempted to simplify the control process in an easy-to-interpret fashion. A system for exercising efficient and effective control of an exchange of any size is proposed which incorporates controlling action conducted during three separate weekly time periods within a month. In short, it emphasizes a step-by-step process for analyzing progress towards desired goals at more frequent intervals.

[redacted]

May 1962
Master of Science in Management
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A SYSTEM FOR NAVY EXCHANGE MANAGEMENT CONTROL

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A Research Paper

Presented to

the Faculty of the Navy Management School

U. S. Naval Postgraduate School

* * * * *

In Partial Fulfillment

of the Requirements for the Degree

Master of Science in Management

* * * * *

By

Charles C. Madeira
LCDR SC USN

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TABLE OF CONTENTS

CHAPTER PAGE

I. INTRODUCTION 1

A. The Need for a System 1

B. The Meaning of the System for Control 4

II. THE FUNDAMENTALS OF NAVY EXCHANGE MANAGEMENT CONTROL. 8

A. The Essentials of Managing An Exchange 9

B. The Technique of Navy Exchange Management Control 10

C. The Control Structure and Information Flow . . 13

D. The Control Assistant 15

E. The Presentation of Control Date 18

III. THE CONTROL IN ACTION 24

A. The Operating Budget Position 24

B. The Mid-Month Performance Position 26

C. The Operating Statement Position 33

IV. THE VALUE OF THE SYSTEM 38

BIBLIOGRAPHY 42

APPENDIX. 44

A. Performance Standards 45

LIST OF FIGURES

FIGURE PAGE

1. Position Time Period Sequence Chart 14
2. The Control Structure and Information Flow Diagram . . 16
3. Specimen Sales Segment Control Chart 20

CHAPTER I

INTRODUCTION

A. The Need for a System

Management of a modern serviceable Navy Exchange enterprise is an increasingly complex task as the exchange structure becomes more disparate. An exchange may encompass a retail store of nineteen departments offering services in cobbler and barber shops, food service activities, vending machines, service stations, laundries, tailor and dry cleaning, photography, watch repair, personal services and clubs for enlisted personnel other than Chief Petty Officers. In some exchange complexes there may be as many as ten retail stores, twenty food service outlets, and offering services ranging from newspaper and milk delivery to taxi service, depending upon regulations for the area in which the exchange is located. Exchange monthly sales may range from $10,000 in a small exchange to $1,000,000 in a large exchange.

This disparate group of parts in an exchange structure requires effective management control. Therefore, the Navy Exchange Officer (abbreviated NEO)--the one who is responsible for the over-all success of the undertaking--needs more than ever three attributes. He needs, first of all, to have a broad understanding of the principles upon which sound Navy Exchange management practices are based. Second, so that he can make proper policy decisions and initiate top-level action promptly when and where needed, he also must have a clear understanding of the

present position of his business from every standpoint which can have an influence on its overall success. And, thirdly, he must learn that finding trouble before it becomes significant is as important as preventing mistakes.

It is not easy for the NEO to get a sufficiently clear picture of the way his business is going to permit him to make decisions with a feeling of complete confidence. This is true whether an exchange is small, medium-sized, or large. In the case of a small exchange, the innumerable details of running the business fall on the shoulders of one man. He must not only do all the planning, organizing, and directing--the typical functions of exchange management--but he must usually also struggle with the detailed problems of sales, service, personnel, accounting and the like. Functions which are delegated by exchange management to specialists in a large exchange must be handled personally by the NEO of the small exchange. He cannot afford to employ specialists, so he finds himself shouldering a heavy burden of detail, often in areas in which he is not particularly well informed.

The result is an overload of petty detail and a confusion of perspective. The small NEO all too often instead of managing his business finds himself being managed by the pressure of events. He spends his time dealing with emergencies as they arise daily or even hourly and has little time or energy left for the true management of his exchange. The statistical information usually available to him is not collected in an easy to interpret fashion;

thus, the overall view so badly needed is lost.

The NEO of the medium-sized exchange is in little better position. His business has attained the size where he can begin to employ specialists and delegate responsibility, but in the very act of doing this, he begins to lose that intimate knowledge of the details of the business which he had when he was handling everything himself. Without a well-organized set of control information, he is likely to find himself "flying blind". His decisions are made more on the basis of hunches and guesswork than they are upon complete knowledge of all pertinent facts. Although a sound business can weather the effects of a surprising number of wrong decisions, it is obvious that operating results will be greatly improved as the percentage of wise management decisions increases. An extremely close relationship exists between decision making and a well thought out concept of control.[1]

The NEO of the large exchange is even more dependent upon the adequacy of the control information that is furnished to him. In his case the organization has grown to such a size that he cannot possibly keep in personal touch with all of the key people whose combined activities are responsible for the success of the undertaking. To attempt to operate on a centralized, rather than a decentralized basis of personal contact and uncoordinated

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[1] Wm. Travers Jerome III, Executive Control--The Catalyst. (New York: John Wiley and Sons, Inc., 1961), p. 10

reports, either verbal or written, dealing with all the matters on which the NEO should be informed, is to attempt the impossible.

> However, you can't decentralize without very much better control of performance, very much better control of objectives, than most business have ever heard of. Decentralization means that you set up a unit autonomously in such a manner that it operates against standards, objectives, and goals rather than against supervision. The major problem is a control problem which very few businesses either understand or have the controls for.[2]

In an effort to respond to this need for control information, the Navy Ship's Store Office (NSSO), Brooklyn, N. Y., the central management office of the Navy Resale System, recognizes the need for statistical control information and customarily forwards data to all exchanges in the system. All too often, however, this information is not accumulated and synthesized properly for efficient management control and thus becomes of little value for decision-making purposes. Data from NSSO are received during the month following the actual operating month, it is obvious the information is received too late for corrective action within the month; therefore, a need exists for a more effective means to exercise efficient control of an exchange.

B. <u>The Meaning of the System for Control</u>

This paper will set forth a description of a practical system of management control designed as the NEO's top management tool for control of his diversified enterprise; therefore, this

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[2]"Why Top Management Control Needs Tightening", <u>Dun's Review and Modern Industry</u> (October 1956), a quote attributed to Peter Drucker.

system is not written for salesclerks or bookkeepers, but for the man who must exercise final control, the NEO of a Navy Exchange.

We shall refer to this system of management control as Navy Exchange Management Control (abbreviated NEMC and pronounced NEM'-SEE). It is designed to give the NEO of the small, medium-sized or large exchange the information he needs to direct his business properly. It is expected that NEMC will aid in presenting information in an easy-to-interpret form so that the NEO will find it requires much less time to absorb than the less complete and less well-coordinated data he has been using in the past.

NEMC should present to the NEO and the others of his management staff a method enabling them to have a clear picture of where the business stands now, how it got there, and where it is expected to go in the future. It should facilitate decision making, because it is designed to present clearly the facts on which the decisions should be based. By providing a clear understanding of what the situation is, and hence, where the problems that need attention lie, the method should simplify the task of exchange management.

Although the paper is to be a practical guide for those who wish to install and use the method, it should also have a great deal to offer the serious student of Navy Exchange Management, whether he is already a practicing NEO, or a beginner just preparing to enter the field. By describing a method of gathering, preparing, and interlocking all of the pertinent information required to give a picture of the past, present, and probable

future status of the exchange, it should give the reader a clear insight into the side of management which involves getting the most out of a given set of circumstances. Although it by no means overlooks the possibilities of growth through the expansion of sales, the reduction of costs through the improvement of methods, and the like; this paper is primarily concerned with focusing attention on how to go about getting the best results from the situation in which an exchange finds itself at the moment. Certainly it is just as important for the NEO to maximize profits and offer efficient service out of today's operation as it is for him to seek greater profits and services through expansion. Indeed, if the exchange is not an efficient business at the present moment, immediate improvement in profits and services of the operation is necessary as a prerequisite to plans of expansion.

This viewpoint of optimizing performance for efficient results is important, particularly for the young man just entering the field of Navy Exchange Management. It is easy to become so interested in a particular part of exchange management--expansion planning, retail procurement, price reduction, cash control, personnel administration--that all perspective is lost. This emphasis on a particular phase of management may appear to be the answer to all problems in the mind of the young enthusiast; whereas, it is balanced management that holds all the functional tasks of a disparate organization in proper relationship. Balanced exchange management is essential for over-all success. This paper, therefore,

is intended to encourage balanced management perspective.

Research indicates that standards have been developed to establish measures of performance for comparison with actual results as shown in Appendix A. These standards are for guidance in preparing for the monthly, seasonal, and yearly cycles of an exchange operation. However, this guide has the shortcoming of implying that the performance standards set forth are normal for exchanges in the Navy Exchange Program. Also, Appendix A may be interpreted that measurement of performance should only be accomplished on a time period of a month or more.

NEMC is developed to encourage measurement of performance within the monthly cycle as well as at the end of the month or during a seasonal or yearly cycle. Of course, if the monthly cycle improves so will the seasonal and yearly cycle.

CHAPTER II

THE FUNDAMENTALS OF NAVY EXCHANGE MANAGEMENT CONTROL

The task of managing an exchange to success is one that can be either a pleasant and satisfying experience or one that is filled with a series of exasperating frustrations. It all depends upon the care exercised in planning for the future operation and the adequacy of the controls available to the NEO.

This is particularly true in the case of those who manage, direct, and develop the small and medium-sized exchanges which constitute the majority of the Navy Exchange Program. Unless the energy and enterprise of their Exchange Officers are based upon a clear knowledge of what is going on in their exchanges, as recorded by their figures, they may well endanger present security and future success of the Navy Resale System and the Navy Recreation Program. They are not surrounded, as the NEO's of the large exchanges are, by mature and experienced department managers who can advise and assist. They must themselves provide both the departmental background of good specialized management and, in addition, good overall management of the undertaking as a whole.

The distinction between exchange and specialized management lies in the fact that exchange management must work from the top downward, while specialized management must work from the bottom upward. The general well-being of a going concern can only be watched from the top.

A. The Essentials of Managing An Exchange

The NEO is responsible for the safe conduct of the exchange as a whole; whereas, the departmental managers are responsible for the results produced in their own departments. It is essential that the NEO understand how to balance the activities of the different departments so they work smoothly together as one integrated whole. This perspective in proper balancing of departments will assist the NEO in determining which member is "out-of-step" with the group. Through guidance and encouragement the NEO must show departmental managers "How" coordination is required for successful integration of all departments of the exchange group.

The NEO, however, must be cautious not to devote too much attention to any one member. If too much attention is given to one member, more than one department may become troublesome.

The NEO's approach must forever be based upon the safety and prosperity of the over-all business. For that reason, he must keep in the closest touch with what is going on both internally in the departments, and externally in the command and business area. Above all, he must have the business acumen of knowing where he does not have enough data for proper executive action.

For this he needs information--external and internal. External information on matters that affect him depends on where the exchange is located. Since external information is an individual matter, it will not be considered here. The internal information he requires to keep him in touch with the progress of the exchange and

with departmental activities is always at hand, available for use if it is presented to him in a convenient manner. If he does not use it, the fault lies with him, and with him only--since to keep himself informed of the true state of affairs as to the past, present, and probable future fortunes of the business is the first and most important responsibility that his position entails. Only if he knows clearly what is going on can he hope to manage and control his business. If he does not do it, nobody else will.

The first sign of trouble will soon show up in the exchange's figures. The knowledge of trouble areas is a prerequisite to corrective action. If the NEO can recognize the areas in time remedies can be applied before real harm is done. He needs forever to be asking "Why?" since from these inquiries will arise all the problems, solutions, and actions that constitute exchange management. But the first thing he will need, as a basis for exchange management, is a simple and clear statement of what is occurring in the business at different times. A statement is not only necessary at the end of the month but also early enough during the month to enable the NEO to take prompt corrective action before the month is over. The method described in this paper provides these statements and so can be justly said to be the key to exchange management for the NEO.

B. <u>The Technique of Navy Exchange Management Control</u>

Control is the executive action arising from the combined NSSO and NEO's policy decisions. It is essentially active and not

passive. In studying the problems involved in NEMC, particular care must be taken to restrict the field to the important elements involved, as it is fatally easy to develop a structure which becomes far too complicated for practical day-to-day use. In NEMC we are not only concerned with the process which starts from the policy decisions made as a result of the intelligent study of the facts and figures provided for the purpose, but also the need for commitment and follow-up so aptly stated by William Jerome:

> To achieve rigorous planning and control, whether in the short or long run, two basic requirements must be met: (1) there has to be a commitment on the part of managers to some projected goals or results; and (2) there must be an eventual comparison of actual with projected results together with an explanation of any material differences. Without such an "audit" (or measurement) of achievement, planning and control will lack discipline and lose part of their "educational" benefits.[3]

This statement by Jerome serves as an introduction to the meaning of NEMC, but does not define it. NEMC is a system of planning and collecting, displaying, and integrating control data in sufficient time for the NEO to direct prompt corrective action.

In order to present NEMC distinctly, the range of activities involved in the system are divided into three segments called positions. Each position has a specific time period for characteristic action required for the complete system. The titles of the positions imply the broad characteristic action that will be described.

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[3]Jerome, op. cit., p. 107

1. The Operating Budget Position (Position I)
2. The Mid-Month Performance Position (Position II)
3. The Monthly Operating Statement Position (Position III)

The first position is concerned with the planned performance of the exchange; whereas, the second and third positions are concerned with actual performance or operating results of the exchange. The reason for this division is that it is of primary necessity that a plan of performance be prepared in advance during the Position I time period. Following Position I the first controlling action will take place at mid-month during the Position II time period. The second controlling action will take place during the Position III time period as soon as the exchange receives the operating statement for the previous month's operation from NSSO.

The planned performance action taken during the operation budget position is prepared four months in advance of actual performance. For example, the operating budget prepared and submitted prior to 10 April 1962, is the projected plan for August 1962. The operating budget position results should be available for review purposes during the first week of a calendar month. Since the operating month of an exchange begins on the 26th, the results from the mid-month performance position should be ready not later than two days after the mid-day of the operating month under review or within the second week of the calendar month. The monthly operating statement position results, on the other hand, should be available for control purposes at the beginning of the third week of the

calendar month following the month under review.

The position time period sequence chart outlined in Figure 1 illustrates the time periods for position action during the calendar months of April, May, and June, 1962.

C. The Control Structure and Information Flow

To describe NEMC further, a control structure is designed for establishing the framework for information flow of positions. Information is gathered into Position I for one plan and into Positions II and III for two control reports. These are submitted to the NEO during the first, second, and third weeks of a calendar month respectively. After review of these documents the NEO will hold three separate meetings within the time period allocated for each position. These meetings will be held with his department managers to discuss the plan, the results, and the corrective action. After the first meeting the NEO should be able to submit his operating budget to NSSO for review and approval. After the third meeting he should be adequately briefed to make his own monthly report to NSSO which should be required for coordinated analysis between NSSO and the NEO.

The control structure and information flow diagram is shown in Figure 2. In this diagram the reader will notice a number of monthly plans and reports to be made by the department managers. It is of the utmost importance to the control method that these reports be kept as brief as possible and submitted on time.

Time Periods for Position Action	Calendar Month
	April 1962
Position I April--Prepare Operating Budget for August	2 to 7
Submit Operating Budget for August	7 to 9
Position II April--Review Mid-Month Performance for April.	9 to 14
Initiate Corrective Action from Position II Control Report	16
Position III April--Review Operating Statement for March	16 to 21
Submit Report for March	21 to 23
	May 1962
Position I May--Prepare Operating Budget for September	April 30 to 5
Submit Operating Budget for September	5 to 7
Position II May--Review Mid-Month Performance for May	7 to 12
Initiate Corrective Action from Position II Control Report	14
Position III May--Review Operating Statement for April	14 to 19
Submit Report for April	19 to 21
	June 1962
Position I June--Prepare Operating Budget for October	May 28 to 2
Submit Operating Budget for October	2 to 4
Position II June--Review Mid-Month Performance for June	4 to 9
Initiate Corrective Action from Position II Control Report	11
Position III June--Review Operating Statement for May	11 to 16
Submit Report for May.	16 to 18

POSITION TIME PERIOD SEQUENCE CHART

FIGURE 1

Whether it be a small or a large exchange, the control activity follows a regular pattern each month. The information relating to the operating budget starts from the various functional managers, passes to the control assistant who summarizes it and makes up the operating budget in the rough. The Position I meeting is held and the NEO approves it for submittal to NSSO. Position II information relating to the mid-month follows the same flow and after the second meeting the NEO makes his decisions for corrective action which are at once put into effect. Position III information relating to the past month also follows the same flow and after the third meeting the NEO presents his report to NSSO. Policy decisions are transmitted to the department managers verbally or by written instructions from the NEO, which completes the control process.

In the case of the small exchange the control reports and the meetings may be omitted, but the flow of information remains unaltered.

D. The Control Assistant

One individual should be made responsible for collecting the budget, mid-month, and monthly data; doing the simple calculations required; and making up the rough operating budget, control reports, and charts. The routine side of the work can easily be done by a clerical employee, and this will probably meet the needs of the NEO of the small exchange, who should be so closely in touch with affairs that he will not need comments from anyone else.

THE CONTROL STRUCTURE AND INFORMATION FLOW DIAGRAM

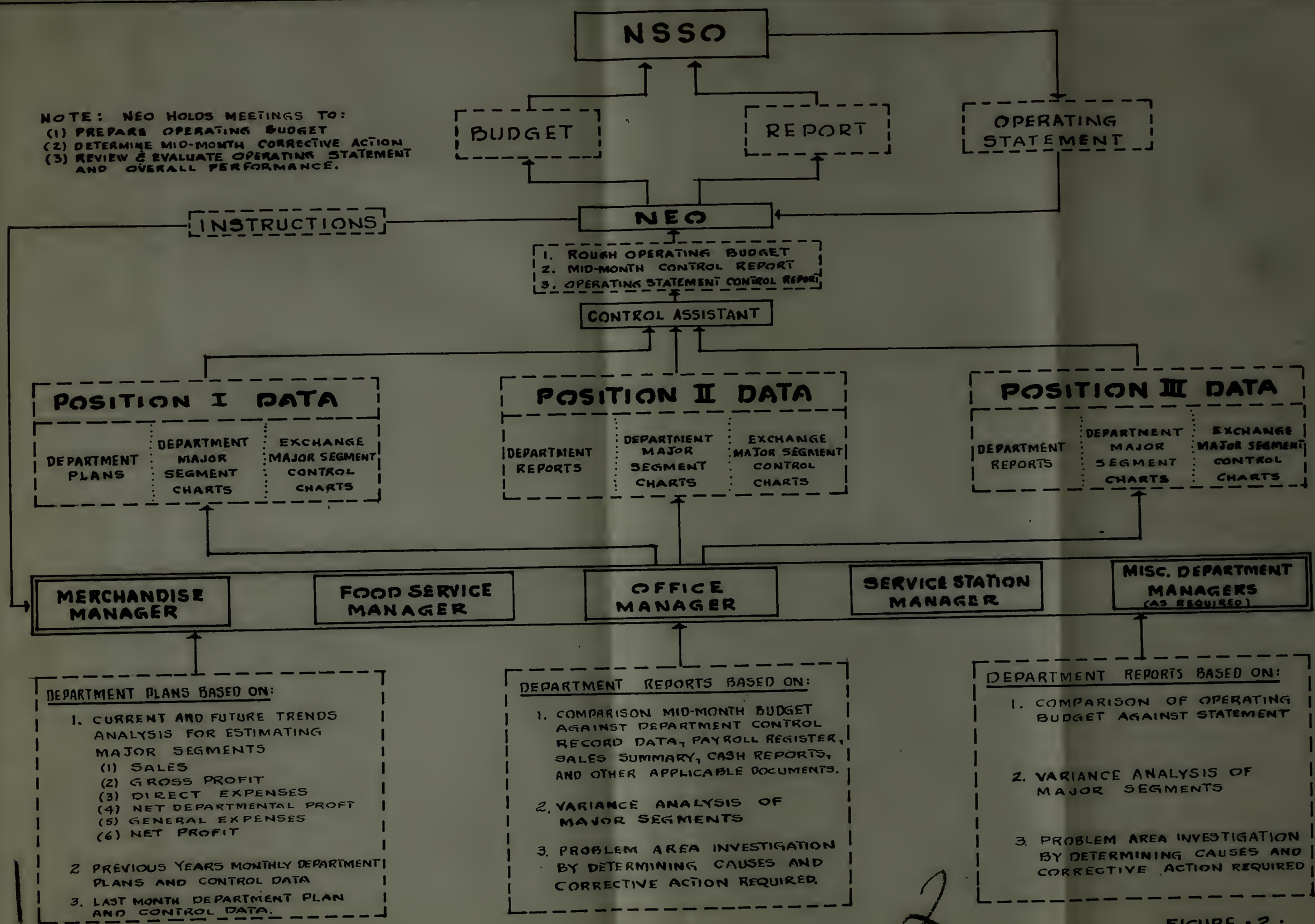

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FIGURE · 2 ·

But in the large exchange, it is important for the results to be surveyed before the NEO sees the rough operating budget or control reports.

At this point it is important to note that employees involved in the function of coordinating and controlling for the NEO are in a staff capacity only.

> Basically, a control unit of any kind is purely a fact-finding and recommendations group. It has no administrative or operating responsibility. Its fundamental reason for being is to make possible an orderly, efficient administration and planning by maintaining the proper flow of facts to top management.[4]

The work can be done by an assistant NEO or by the office manager. Much depends upon personalities and inclination. No matter who may be chosen, <u>someone</u> in the organization must be responsible to the NEO for collecting the data at zero hour and presenting the picture with adequate comments as quickly as possible after the figures are available. This individual shall be called the control assistant.

Provided the monthly plans and reports are kept brief, the sense of completeness which they should give could add to the unity and team spirit of the management group. This will have a tendency to penetrate right down to the bottom throughout the departments. The conscious, planned direction of an exchange is a skilled affair and cannot be carried on without careful analysis and reliable

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[4]Frank A. Lamperti and John B. Thurston, <u>Internal Auditing for Management</u> (New Jersey: Prentice-Hall, Inc., 1956), p. 98.

information. That information, to be effective, must be completely integrated and not merely an uncoordinated collection of figures.

E. The Presentation of Control Data

> An executive should have called to his attention only significant departures or variances from predetermined norms or objectives. The "significance" of the variance, it should be emphasized, is largely a matter of the favorableness or unfavorableness of the trend rather than of the absolute amounts involved. When performance is as planned, the answer to the question "How well are we doing?" is essentially: "We are doing as well as we promised."[5]

It is, therefore, important that the control assistant present his data in a clear and understanding manner. This control data should be presented to the NEO primarily by reports and charts; however, presentation is not limited to these two forms.

The reader will notice on Figure 2, six simple exchange control charts and a number of small department graphic charts are required. The exchange control charts are to be prepared and plotted for sales, gross profit, direct expenses, net department profit, general expense, and net profit; the major segments or variables considered during the three positions of the NEMC method and are designated as the basic set.

The basic set shows the total dollar amount of each segment for all departments combined. For example, the sales segment chart of the basic set will show the total planned sales figures developed during Position I and the actual sales figures of mid-

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[5] Wm. Travers Jerome III, Executive Control--The Catalyst (New York: John Wiley and Sons, Inc., 1961), p. 135

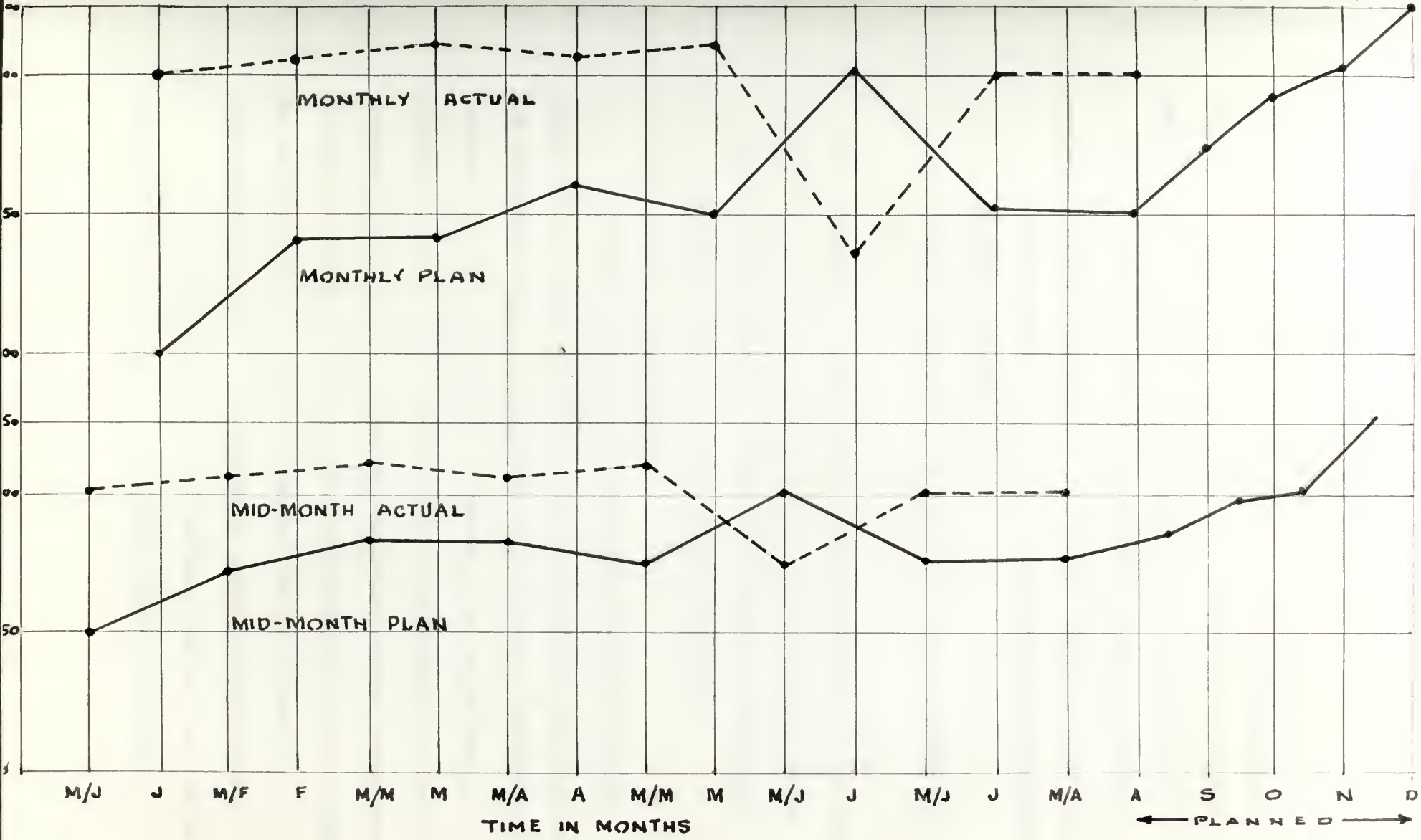
month and end of the month operations. A specimen of a sales segment control chart is displayed on Figure 3. The heavy, dark line shows planned or estimated sales for the exchange projected over a period of time on a mid-month and monthly basis. The dotted line shows actual sales to date.

This type of control data presentation will enable the NEO to visualize the degree of variance of actual from estimated on a trend basis and will aid him in deciding whether further inquiry is necessary or whether everything seems to be progressing satisfactorily. In other words, trend as well as absolutes are clearly shown.

In addition to the basic set of exchange control charts that show the overall exchange totals of segments for planning and control, the control assistant will prepare the small department graphic charts, in booklet form, for the same six segments of each department of sufficient size. Data of departments such as retail, service station, food service and enlisted men's clubs of the medium-sized and large exchange should always be included in the department charts.

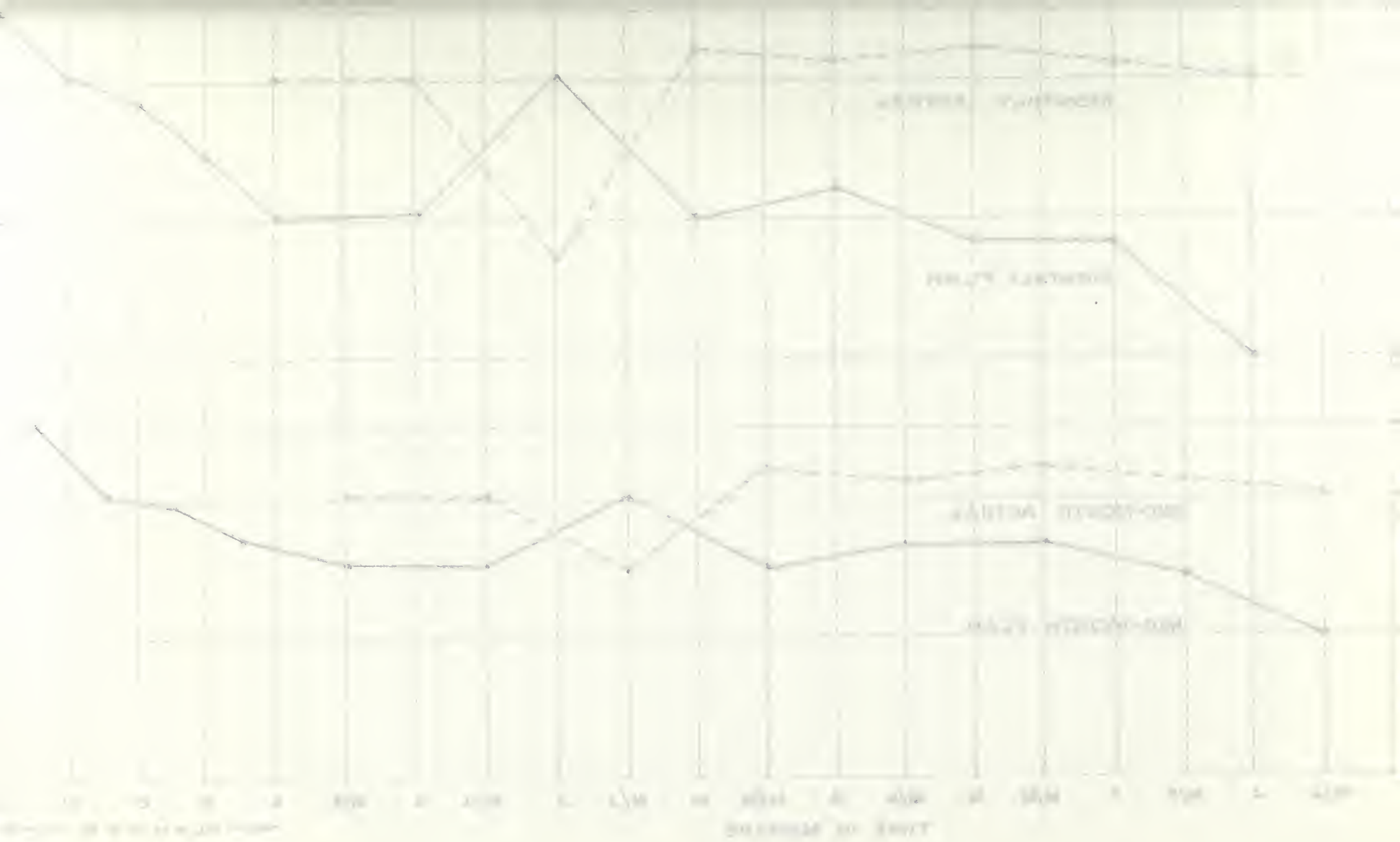
The control assistant will examine and prepare the control data for presentation taken from departmental manager's plans and reports, departmental control records, the operating statement, and other applicable documents.

When the charts are plotted and completed for presentation they should be analyzed by the control assistant to reflect



·· SPECIMEN · SALES · SEGMENT · CONTROL · CHART ··

· FIGURE · 3 ·



information for support of his rough budget and control reports. This is easily accomplished if he uses the charts in the correct manner. What are some of the ways he may use these charts?

(1) To compare accuracy of departmental plans and reports.

(2) To compare both absolute amounts and variance percentages of last month's and last year's estimating to this month's and this year's estimating.

(3) To compare performance in the same manner as number (2) above.

(4) To analyze intra-department cost and revenue fluctuations.

(5) To make the same analysis on an inter-department basis.

(6) To expose sales mix trends (particularly if charts are presented for individual retail departments).

(7) To predict future trends.

The control assistant should possess a list of control limits for each major segment both for the basic set and also for the department charts. These limits will aid him in determining problem areas for presentation. However, it is significant to establish that the NEO is responsible for determining the limits. In establishing control limits the NEO should consider among other things, the historical data of variance percentages and the present and probable future external influences that may affect the characteristic behavior of the internal exchange organization.

At this point the reader should note that not only is the area of external influence an individual matter for further

research, but also the area of control limits requires intensive study. Further investigation of these areas may prove to be important supplemental material for the NEMC system or the Navy Exchange Manual. A guide of control limits may enhance the adequacy of performance standards set forth in Appendix A.

Supplemental information should be presented for study in either of the Position II or III control reports or charts on significant variables as relative or absolute figures. The choice of these indicators is determined from two basic questions. First, what data in addition to the major segments already specified can be collected soon enough to detect how a department or the exchange is doing? Second, what further data are required to help correct problems revealed?

The following suggestions are recommended in determining trouble and in finding solutions to problems. Further they are recommended to direct the control assistant's attention to relative as well as absolute magnitudes.

(1) Inventory to Sales

(2) Payroll to Sales

(3) Overtime Payroll to Standard Payroll

(4) Part-time Payroll to Standard Payroll

(5) Pay Day Sales to Position II and III Sales

(6) Cash Fluctuations (shortages, overages, over-rings) to Cash Receipts

(7) Department Returned Merchandise to Department Sales

(8) Number of Department Items Not Adequately Priced for Display to Number of Department Items Carried

(9) Number of Items Erroneously Priced to Number of Items Marked

(10) New Items Added to Old Items Deleted by Departments

(11) Sales per Employee to Sales per Department

(12) Net Profit per Employee to Net Profit per Department

(13) Number of Items Received per Number of Items Requested by Merchandise Transfer

(14) Number of Items Not-In-Stock per Number of Must List Items Required

(15) Number of Items Not-In-Stock per Number of Never Out List Items Required

(16) Markdowns per Inventory Age Group

(17) Number of Procurement Source Changes

(18) Available Open-To-Buy

(19) Merchandise Cycle Flow Time

(20) Merchandise Transfer Flow Time

CHAPTER III

THE CONTROL IN ACTION

A. The Operating Budget Position

The essence of NEMC is to set realistic attainable goals or objectives and then provide continuing management action to ensure the goals are reached. In an exchange, setting goals is accomplished through the use of the operating budget. The operating budget is not a system of control but a valuable means for control. It is a position taken by coordinating the combined intelligence of the entire exchange into a plan of action based upon past performance and governed by a rational judgment of major variables that will influence the course of the business in the future.

> Budgeting is not just forecasting. It is an exacting and rigorous analysis of the past and a careful calculation of probable and desired future operations. The objective is to substitute deliberate, well-conceived, astute business judgment for accidental success in enterprise management.[6]

This position should reflect the maximum potential of a well run organization. Hence, the operating budget becomes the primary policy making implement at the disposal of the NEO.

The major segments of the operating budget that must be planned by specialized management are the same variables considered during the mid-month and operating statement positions. These segments are also the same variables that constitute the exchange

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[6]Adolph Marty, Othel J. Curry and George W. Frank, Cost Accounting (Cincinnati: South-West Publishing Company, 1957) p. 473.

basic set and department control charts.

In establishing the target figures for these segments the following steps are required:

(1) Obtain detailed sales estimates after consideration of each department individually by it's elasticity, marginal response to seasonal patterns, personnel complement changes, recent history and promotional activity.

(2) Estimate the cost of goods sold by predicting the proper sales mix and deducting prescribed departmental markups and estimated markdowns. Deduct this estimated cost from sales, and gross profit is the resultant.

(3) Secure estimates of direct expenses including payroll, stationary and supplies, repairs and minor replacements, utility expense, retirement annuity contributions and any other miscellaneous expense.

(4) Deduct the total estimated direct expense from gross profit and net department profit is determined.

(5) Determine net exchange profit by deducting planned general expenses, all expenses other than those charged as direct expense, and the central office expense, not to exceed three percent of planned sales, from the total of all net departmental profits.

During this budget process department managers should bring lower supervisory levels into action to require more conscious planning and control. Thus, the budget process becomes a major

means for supervising lower management.

Before submission of the budget figures to the control assistant, the department manager should compare his budget figures with the previous year's and last month's departmental control records. Any significant variations should be justified on the rough department operating budget.

The control assistant reviews and integrates all budget figures received by the managers into the proposed operating budget. He then prepares the control charts mentioned in the last chapter. After this he prepares his summary of the final plans showing under-- and over--budgeting, symptoms of management planning problems, and presents the data to the NEO for the Position I meeting.

At the Position I meeting the NEO will discuss the accuracy of the operating budget inquiring about trouble areas not only presented by the control assistant but also those depicted by hi self. The NEO will explain why any necessary changes must be made. Upon completion of the meeting the operating budget becomes the projected operating statement as the NEO approves and submits it to NSSO.

B. <u>The Mid-Month Performance Position</u>

Prior to discussing Position II, it is important to review the time relation of this position to the position just completed. The time period of Position II is the second week of a calendar month during which controlling action is con-

ducted on mid-month operating performance; whereas, Position I action of preparing the operating budget four months in advance was taken during the first week of a calendar month.

The goal of exchange net profit is eight percent of sales. Net profits equivalent to the first five percent of sales, less the assessment by the Chief of Naval Personnel for the BuPers Central Recreation Fund, are available to local commands for their recreation programs. Net profit between five and eight percent is allocated to NSSO. This is listed as an item of general expense, called central office reserve.

The distribution of the eight percent net profit is unique in comparison to similar operations in the business world. The profits are distributed monthly, and if the goal of eight percent is not attained, only those profits generated are distributed in the same sequence mentioned in the previous paragraph. If the profits do not amount to eight percent the deficiency cannot be made up in a subsequent month.

After monthly results are known a measure of performance may be obtained which will disclose whether the month's performance is up to standard. The true measure of success is to obtain optimal performance prior to the end of the month not only to attain the goal but also not to exceed the goal. To the extent the goal is exceeded, customers have not received their rightful benefits due to improper prices or deficient service. In view of the short period of time available to

maximize efficient and effective control for this objective a mid-month performance position is deemed necessary.

Before developing Positions II and III the NEO should clearly understand the principle of sales dollar control used in the Navy Exchange Program. The idea behind this principle is that the gross proceeds of sales is made up of so much for the cost of goods sold, so much for direct department payroll, so much for general expenses, for non-recurring expenses, and so much for profit. If these items are recorded only in their actual money values, there is no easy means of controlling the fluctuations, as it is difficult to compare, say, the rise of sales with the rise in the payroll cost element of the direct department expense. But if the results are expressed as a percentage per dollar of sales, a basis of comparison is obtained, and "yardsticks" may be established against which the various components of the sales dollar may be measured. As previously mentioned, Appendix A is a guide for these performance standards.

It is not uncommon for the student of exchange management to see the sales dollar tabulations in the operating statements of exchanges as a source of information and not as a source of control. Here we are concerned with the latter, and for that reason the NEO should utilize the operating results as an indicator to manage what needs management.

In NEMC the advantage of the sales dollar percentage calculation is this--since the NEO knows that he should make

eight percent profit on his sales, when clearly ninety two percent of his sales figure consist of costs or expenses. Since the cost and expenses are divided into segments on the operating budget and statement, the NEO can watch each month whether his eight percent profit is being squeezed out by an excessive percentage in one or another of these segments.

To interpret the ninety two percent of sales as a fixed amount of funds available or authorized tobe expended as costs or expenses, is erroneous. The objective is to minimize costs to the lowest possible level but not below the level of cost required for proper customer service. It is also erroneous to change selling price levels arbitrarily as the first choice of corrective action if costs or expenses are exceeding ninety two percent. Although increased selling prices may be the only solution, it should only be considered after all other alternatives have been completely investigated. Conversely, when the profit tends to exceed the goal, the NEO should strive for the point where he may ask himself this question, "What prices may be reduced or what additional service may be provided to decrease profits as a 'bonus' to customers."

To savor the full significance of the review and analysis activity taken at the mid-month performance position which is discussed in the following pages, the reader should keep in mind this caution: in most cases the variables reviewed and analyzed during the mid-month time period are true or actual figures. In

some instances, however, a variable such as gross profit, is taken from departmental operating control records and is a forced figure. This is due primarily to the fact that an actual inventory is too time consuming to be taken at mid-month. Actual figures for sales and expenses can be derived from sales summary worksheets, daily cash reports, payroll registers and other applicable accounting documents. Consequently, a few "findings" derived from the study taken at mid-month can be presumptive only. Useful warning of trouble, in other words, may be obtained from an analysis of the data relating to unproved variable figures. In these instances, mid-month reviews and analysis can only point out potential problems not actual problems.

The sales, general expense and net profit segments provide a particularly useful illustration of certain variables requiring analysis during the mid-month position. The following mid-month data of July 1961, were taken from the results of one of the exchanges in the Navy Exchange Program:

	Planned	% of Sales	Actual	% of Sales	Variance % to Actual
Mid-Month Sales	45,900		42,200		8.1-
Gen. Exp. Payroll	1,110	2.3	1,532	3.6	56.5
Other Gen. Expense	229	.5	301	.9	80.0
Central Office Res.	1,377	3.0	685	1.6	46.6-
Net Profit	2,854	6.2	2,110	5.0	19.3-

All the variance percentages of actual to planned figures are clearly unfavorable and in all cases extreme and indicate trouble areas requiring prompt action to be taken by the NEO prior to the

end of the month. What are some of these trouble areas?

(1) Sales are off target.

(2) Actual general expense payroll is too high.

(3) Other general expense is over the planned level.

(4) The total of central office reserve and net profit is moving toward a total of 6.6% of sales instead of the planned 9.2% and the normal desired goal of 8% of sales.

The figures used in the illustration above would normally be submitted to the control assistant by the office manager. In this example the office manager possesses many trouble areas for suggesting corrective action in his report. The other functional managers should make a similar analysis of their individual departments prior to preparation of their mid-month report.

At this point it is well to make clear that red tape has no place in NEMC. In the medium-sized exchanges some departmental managers may claim they are too busy to make monthly reports on the workings of their departments. This is a shortsighted policy, as they lose a record of any success they may achieve. But since time is a vital factor in control, the control assistant will be wise to check the day before the mid-month on whether he is going to receive all the written reports. His Position II control report must not be delayed if the Position II control meeting is to have the desired effect.

Control reports are made up of certain carefully selected series of accounting, financial, and operating data. Their purpose is to provide management with a continuing, systematic

> review of trends and current developments in each major segment of the business and to call attention to short run or long run conditions that warrant further study and investigation.
>
> In short, control reports call attention to the situations which require special investigation, and accounting records, provide the basic data on which control reports must rest.[7]

In preparing department and position control reports, the managers and the control assistant will always assume that all control charts will be available for review at the control meeting. For that reason, only applicable problem area investigation data should be presented in the reports. This should improve correlation and time efficiency.

The control assistant's task for the Position II control report and charts will not be difficult if he correlates, studies, and reports only significant information on problem areas, bearing in mind that the department managers are responsible for drawing attention to any underlying matters of importance. His Position II control report is a summary of the mid-month results showing major and minor problem areas, the problem causes and appropriate corrective action. When the control assistant has plotted the control charts and has compiled the control report, the Position II control meeting will be held.

Minutes should be taken by the control assistant at the meetings and circulated to all members as soon as possible afterward. All items should carry a reference to some member of the

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[7]John B. McLean, "Better Reports for Better Control", Harvard Business Review (May-June 1957) Vol. 35, No. 3, p. 97.

meeting, who will be responsible for reporting progress by the Position III meeting or subsequent meetings until the matter has been settled. The last entry will then end with the word "completed" to show that it will not be brought forward again.

In this manner, no matter raised at a control meeting is allowed to rest until settled, and some one member is responsible for that settlement. This procedure should provide a valuable stimulant to progress and should help to prevent the side tracking of unpleasant or complicated problems.

It is important to keep before the members the date on which an item was first raised as an aid to influence follow-up and feed-back.

All old business is dealt with first, and the current status of each item is recorded. Then any new business is considered and members are free to bring up any matter which they feel of sufficient importance to be investigated.

For NEMC purposes, position meetings that follow this plan should be more conducive to promoting corrective action than the type which deals with a new agenda on each occasion. The follow-up plan will also show the significance of the mid-month position--finding short run problem areas for immediate corrective action.

C. <u>The Operating Statement Position</u>

The time period of this position is the third week of a calendar month; whereas, Position II action of mid-month performance just reviewed was taken during the second week. This operating

statement position considers the previous month's operating statement.

Position III becomes the most realistic position of NEMC from the standpoint that in this position exchange management is comparing actual results of variables with the operating budget figures. This comparison is shown on the operating statement forwarded by NSSO to each exchange in the system.

For the Position III control report the control assistant will be responsible for synthesizing data to show why the figure of profit is what it is, how the exchange is moving in relation to the operating budget target figures for the year to date, and whether any deficiencies highlighted in the operating statement are being corrected by current action.

First he will deal with the operating statement. He will not only compare the control data of the major segments but will also compare the data chosen as supplemental information after plotting the information on the control charts. Then he will proceed to compare this data with the summary departmental control records to detect misleading information that may be found in the departmental manager's reports which should have been received by this time.

While analyzing this data he will prepare a note sheet of items that are deemed questionable. This note sheet is an important factor in the proceedings as it compels the control assistant and the NEO to go through the charts and results one by one and to

note down whether the direction of movement is favorable or unfavorable; and whether the current month results as seen in Position II are satisfactory or not. Once the note sheet is completed, a quick review gives an impression of the previous month's problems as a whole that required control and also points to where corrective action should be initiated, continued or stopped.

It is important for the reader to note that the NEO participates in this preliminary analysis and review in order that all possible problem areas are exposed for further review and analysis. During the preliminary analysis all problem areas should be listed on a priority basis not only from the viewpoint of dollar variance, but also percentage variance of actual to planned figures.

When he is satisfied that he has made a proper survey of the operating statement, the control assistant will compare the note sheet with the departmental reports to ensure that problem causes and appropriate corrective action have been specified by the managers.

Having made up his note sheet and studied all problem areas, he will proceed to prepare his Position III control report which he will review with the NEO, the charts being available at the time.

As soon as the NEO has satisfied any wish for further information, he will call the Position III control meeting. Once again all the departmental managers will gather round the table, and matters arising from the report and charts will be fully discussed. Minutes will be taken to fix responsibility as previously outlined.

Before completing the "Control In Action" it is appropriate to consider warnings or "caveats" for the NEO, an executive, expressed by Wm. Jerome.

> First, reports or charts in themselves do not provide control except to the extent that they aid executives to ask the right questions about the right factors. Even then control will depend not just on the questions but on the promptness and effectiveness of the follow-up action taken to bring actual performance in line with desired performance.
>
> Second, an executive must beware lest he rely too much on any one or two favorite charts or indexes. Subordinates quickly become expert at manipulating the factors that improve their showing in any single phase of operations.
>
> Third, it behooves the executive to beware of his reaction to unfavorable trends as revealed by reports. The temptation exists to jump to conclusions and distribute blame without first grasping what is really going on. Things always look deceptively self-evident in reports or on charts.
>
> Fourth, the executive must never forget that a major use of reports (as well as plans and budgets) is to "educate", not to fix blame. In other words, reports encourage orderly thinking on the part of all executives about the entire operation of the firm.[8]

With the above note of warning to the NEO the control process shown on Figure 2 has now been completed up to the point at which the NEO prepares his report to NSSO. This report will be prepared on a "management by exception" basis, explaining the variations and the events which have caused them during the past month. Further, the report will include corrective action initiated for prevention of the same problem in the future.

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[8]Jerome, op. cit., p. 145

After the NEO's report is submitted to NSSO, the control process is completed. If NSSO replies to the report with further instructions they should be issued by the NEO to retail, service and accounting departments.

If the control structure has been correctly built up, not only all the information relating to the operating budget, mid-month performance and the operating statement positions will have been reviewed, but also problems will have been analyzed, and corrective action will have been taken.

At this point the reader's attention is invited to the fact that the NEO's report to NSSO is not a requirement at the present time; however, the report is strongly recommended regardless whether the NEMC system is adopted. The report would improve coordinated analysis and aid NSSO's management control of the Navy Exchange Program.

CHAPTER IV

THE VALUE OF THE SYSTEM

Only those NEO's who have had experience with handling exchanges, which are working at full capacity or those which are rapidly decreasing in volume, can have any idea of the pressure under which, in such circumstances, the managers spend their days. Time is their enemy. There is not time for weeks to be spent in drawing up plans of this or reports of that. Often before these studies and analyses have been finished, the next month's operating statement has come in and new studies must be made. The NEO must have some first-aid method, as simple and quick-acting as possible, so that the moment he has control data he can take whatever action these data show to be necessary for optimal performance. A close control of what is happening offers the one hope of survival.

A control system is not a panacea for bad exchange management. It may present a clear picture of what is going on, but that is all it can do. If exchange management is poor, a control system will not ensure success. The responsibility for that, as for all other matters affecting the exchange as a whole, must lie with the NEO.

The NEMC system need not entail a special staff or any intricate calculations. In effect, it merely takes worth-while variable information from records already maintained and presents them in a framework which enables the NEO to direct action more promptly, in a coordinated manner, instead of a disconnected series

of reports. It is important to bear this in mind; the reader should not visualize a sudden influx of more employees, a heavy increase in expense and disorganization.

The additional workload required is that of the control assistant. The preparation of reports, if kept brief, is a matter of a few hours a month. The meeting, if conducted properly and based on management by exception, should not be very time consuming. The actual cost, therefore, of operating the control once it is installed may be said to be negligible.

The NEMC method offers a form of control which can be adopted at any exchange. Every exchange has its operating budget and operating statement problems. The addition of the mid-month performance review will aid in isolating, defining, and watching these problems within the month and will encourage improvement of operations.

Moreover, NEMC has the further advantage in that it can assign managerial responsibility. It isolates the major functional problem areas and those problems can be referred to the individual responsible for corrective action. NEMC with its consideration of the three positions, all surveyed in proper balanced perspective, can enhance profits and service. If continuous review of the activity of the exchange is maintained NEMC will be an effective system.

It might possibly be assumed that the method is only suitable

for large exchanges because references are made herein to specialist managers who usually exist only in exchanges of some size. This is not the case. The responsibilities of management exist in every exchange. Whether each functional responsibility is handled by a separate individual or one overburdened person carries all responsibilities, the fact remains that those responsibilities have to be met if the business is to be run efficiently. The control has been worked out so as to isolate, as far as possible, the functional results. Those results can then be referred to the individuals responsible in a large exchange. In a small exchange, they indicate to the NEO which particular section needs attention.

In one respect, perhaps the most valuable side of NEMC is that it lends itself admirably to the training of prospective NEOs in exchange management problems. Much has been done in recent years towards improving the teaching of exchange management in order that the new officers assigned to Navy Exchanges may start with a proper knowledge of how they should go about their work as their responsibilities increase.

NEMC is concrete and therefore can be taught. It is not a network of nebulous theories. It can be readily adapted for use with the case study approach.

A student with training in NEMC will have a far better chance of making early headway in his assignment than one who starts without it.

To the NEO of an exchange, the problem of greatest importance

is an efficient means for control. The time is passing when failure is accepted as merely a question of bad luck. A simple and effective guide for management control of an exchange is one of the most urgent needs of the Navy Exchange Program today. It is confidently believed that this system of NEMC offers to those responsible for the success of an exchange a solution to their control problem.

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APPENDIX

3. PERFORMANCE STANDARDS

a. General. The performance standards set forth in subparagraphs b through d are suggested for Navy Exchanges.

b. Retail Departments

Sales Volume Grouping	*Gross Profit (%)*	*Maximum Payroll (%)*	*Maximum Total Direct Expense (%)*	*Minimum Net Department Contribution (%)*
$ 0– 10,000	14.0	3.4	4.0	10.0
10,001– 35,000	14.5	3.4	4.0	10.5
35,001– 80,000	15.2	3.2	3.8	11.4
80,001–150,000	15.8	3.2	3.8	12.0
150,001 and over	16.5	3.0	3.6	12.9

c. Service Departments

Department	*Minimum Gross Profit (%)*	*Maximum Payroll (%)*	*Maximum Total Direct Expense (%)*	*Minimum Net Contribution (%)*
J-1 Barber	95	82	90	5
J-2 Cobbler	65	55	60	5
J-3 Service Station	20	8	9	11
K-1 Tailor & Dry Cleaning	60–90	45–75	50–80	10
K-2 Photography	(Details in Chapter 4)			20
K-3 Watch Repair	(Details in Chapter 4)			20
K-4 Food Services				
Under $7,000 Monthly Sales Volume	40	23	28	12
Over $7,000 Monthly Sales Volume	40	21	26	14
K-5 EM Clubs (Continental)	35	18	22	13
K-5 EM Clubs (Overseas)	40	19	23	17
K-6 1st & 2nd Petty Officers' Clubs	45	20	25	20
M-1 Laundry	90	60	80	10
M-2 Personal Services	(As applicable to individual services authorized)			
M-3 Vending Machines				15

d. General Expenses and Other Income

	Percent of Total Sales
General Administrative Payroll	
Group I $ 10,000 and under	2.7
Group II 10,001–$ 35,000	2.7
Group III 35,001– 80,000	2.7
Group IV 80,001– 150,000	2.5
Group V 150,001 and over	2.3
Group VI Reserve Air Stations	2.4

		Percent of Total Sales
Other General Expense		
Continental (exclusive of amortization)	Maximum	1.4
Overseas (exclusive of amortization and contract labor)	Maximum	0.8
Other Income		0.4

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